



**TESTIMONY OF
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PRESIDENT
THE SOCIAL SECURITY INSTITUTE**

**ON
THE CHAINED CPI**

**SUBMITTED TO THE
SUBCOMMITTEE ON SOCIAL SECURITY
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES**

APRIL 18, 2013

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Lawrence A. Hunter, Ph.D.
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“A promise made is a debt unpaid.” ~Robert W. Service

Introduction

My name is Dr. Lawrence A. Hunter, President of the Social Security Institute (SSI), a 501(c)(4) non-profit, non-partisan, seniors’ advocacy organization located in The Plains, Virginia. SSI seeks to promote the retirement security of today’s seniors and the seniors of tomorrow. Our top policy priorities are to ensure that promises made by Congress to today’s seniors in the Social Security program are promises kept and to seek reform of the program to make it just and sustainable for the seniors of tomorrow.

On behalf of SSI and the many thousands of seniors who support our efforts, I am submitting this written statement in opposition to the proposal to substitute the Chained CPI for the CPI used currently (CPI-W) to calculate annual cost-of-living allowances (COLAs) for Social Security recipients.

Three Reasons Not to Substitute the Chained CPI for the Current CPI-W

For more than three decades, I have conducted and published extensive research on Social Security in all its facets, including the financial problems that plague the program long term and what must be done to reform the program. I believe there are three primary reasons Congress should reject the President’s Chained CPI proposal—a bipartisan proposal supported by many Republican Members of Congress, I might add.

First, contrary to much disinformation spread about the CPI, it currently underestimates true inflation rather than overestimates it. This is not the first time a president has proposed fiddling with the CPI as a backhanded means of cutting Social Security benefits for current retirees. In fact, the CPI has been altered numerous times during the past four decades in ways that have compounded and exacerbated the understatement of inflation so that today consumer price inflation, as reported by the current CPI-W, is understated by roughly 7 percent a year.

The compounding effects on Social Security benefits of the changes made to the CPI have been dramatic. As CPI expert John Williams puts it:

“Changes made in CPI methodology during the Clinton Administration understated inflation significantly, and, through a cumulative effect with earlier changes that began in the late-Carter and early Reagan Administrations have reduced current social security payments by roughly half from where they would have been otherwise... The compounding effect since the early-1990s has reduced annual cost of living adjustments in social security by more than a third.” (See http://www.shadowstats.com/article/consumer_price_index for a thorough analysis of what is wrong with the current CPI and how replacing it with the Chained CPI would only make matters worse.)

It would be wrong to compound these errors further by enacting another misguided change to the inflation index. If anything, the current CPI should be changed in the other direction to reflect the higher rate of inflation more accurately, especially the relatively greater price increases faced by most senior citizens.

Second, Social Security is in need of a complete overhaul, and patchwork proposals such as the Chained CPI confuse true reform with *ad hoc* tinkering designed to reduce spending on the program in the name of deficit reduction and debt control. Even if the Chained CPI were well conceived—which it is not—substituting it for real reform will only make agreement on real reform harder to obtain. Tinkering with the CPI is not reform, and seniors know it. Finagling the CPI only reinforces the cynicism about Washington that pervades the land.

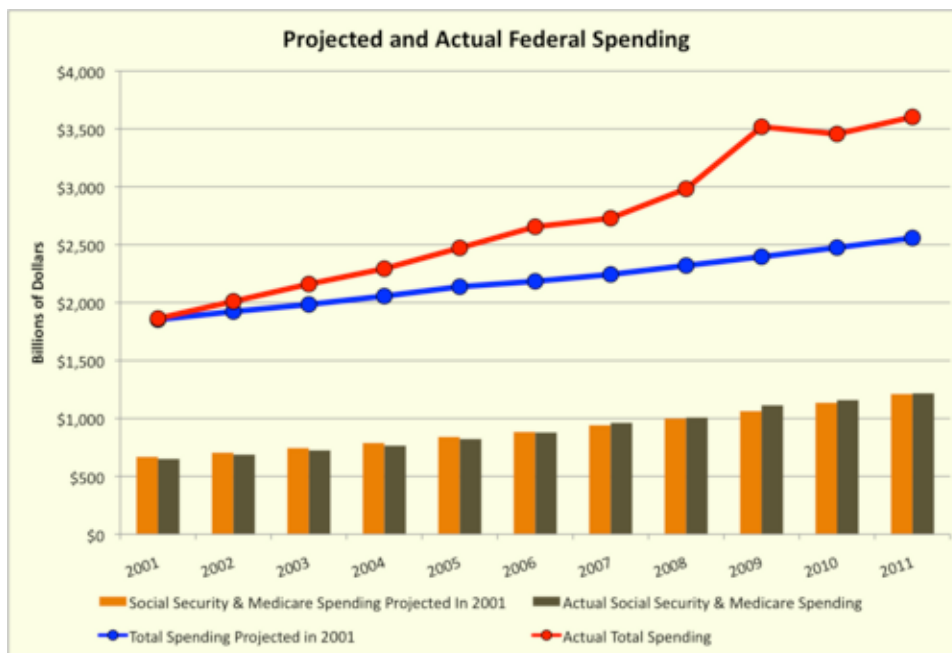
Already Americans believe that when politicians say “tax reform,” they mean “tax increases,” and when they say “Social Security reform,” they mean “benefit cuts.” And make no mistake about it; the so-called Chained-CPI “reform” would constitute a significant benefit cut for current retirees. According to the Social Security Administration, the average earner retiring at age 65 would lose \$658 each year until they turned 75 under Chained-CPI, and a \$1,147 cut by 85. And, the so-called “birthday bump” in the Obama Administration’s Chained-CPI proposal (an increase in benefits in the 20th year to help offset the cuts), still fails to make up for the benefit cuts.

Finally, Social Security does not currently contribute to the annual federal budget deficit, and therefore it should not be tampered with in the name of deficit reduction. Pinning the blame for the deficit and debt increases on Social Security erroneously conflates tomorrow’s anticipated Social Security deficits with today’s general fund deficits, which are completely unrelated to Social Security and are caused by excessive federal spending in every federal program other than Social Security.

In 2001, the Congressional Budget Office (CBO) projected that combined Social Security and Medicare spending (orange bars in chart below) would equal \$1,211 billion in 2011. Last year, combined Social Security and Medicare spending (green bars) amounted to almost exactly that, \$1,216 billion.

In other words, as this chart demonstrates, Social Security and Medicare spending combined last year was exactly what CBO projected it would be back in 2001 when CBO was projecting a \$900 billion federal budget surplus. At the same time, as the chart also demonstrates, total federal spending (red line) rose much faster than was projected (blue line). As a result, the federal government spent a trillion dollars more in 2011 than was projected the day Bill Clinton left

office. It is unambiguously clear that the additional trillion dollars in spending came from somewhere else, not the retirement programs, and certainly not from Social Security.



The Raid On Social Security and the Chained CPI Ruse

For more than 20 years after Congress “reformed” Social Security in the mid-1980s, American workers were forced to overpay Social Security taxes to build up a surplus in the Social Security Trust Fund, which now holds more than \$2.5 trillion in federal bonds as a result. Workers and retirees were promised those surpluses would safeguard and guarantee their Social Security benefits and secure them from cuts.

Instead, Congress raided the Trust Fund and used the surpluses to expand the rest of the federal government by spending the surpluses on everything *but* Social Security; on everything from paper clips to battleships.

According to the Social Security Trustees, there are sufficient federal bonds in the Trust Fund to ensure that all Social Security benefits are paid in full and on time for another 20 years, until 2033. This arrangement is no different than private pension funds holding federal bonds as assets. Therefore, it is impossible to justify any cuts to Social Security benefits between now and 2033 on the grounds of deficit reduction and debt control. As for looming Social Security deficits after 2033, Congress remains derelict in its duty by refusing to overhaul the program for the long term to avoid the program’s implosion. Arguments that the Chained CPI is the first incremental step toward such an overhaul are disingenuous and quite simply baloney. The Chained CPI is an immediate benefit cut without a scintilla of real reform, pure and simple.

The United States Supreme Court ruled in 1960 (*Flemming v. Nestor*, 363 U.S. 603) that Social Security does not constitute a legally binding contract, and therefore Congress may alter or even repeal the program at will without paying recipients compensation. However, the promises made by Congress to the American people with Social Security combine with the self-evident *quid pro*

quo on which the program is based (FICA contributions sooner in exchange for retirement benefits later) to create an indisputable political and moral obligation far more important than a mere legal contract. Congress has demanded that workers pay a lifetime of FICA contributions to earn their promised benefits, and it would be the height of hypocrisy and villainy for Congress to renege on that promise because it cannot find the courage to reduce other excessive federal spending.

Additionally, Congress is obliged to pay all interest on the Social Security bonds and redeem them when the time comes to pay current retirees' Social Security benefits in full and on time as promised. In the words of poet Robert W. Service, "A promise made is a debt unpaid."

The Social Security Trust Fund holds more than \$2.5 trillion of federal debt, and regardless of payroll tax cash flow, there is no justification for cutting current retirees' benefits as long as interest on that debt and bond redemption provide sufficient revenue to the Trust Fund to cover all benefit payments. As the Social Security Administration says, "The investments held by the trust funds are backed by the ***full faith and credit of the U. S. Government***. The government has always repaid Social Security, with interest. The special-issue securities are, therefore, just as safe as U.S. Savings Bonds or other financial instruments of the Federal government."

Reneging on Congress's Social Security promises by chiseling COLA payments through the Chained-CPA ruse would be every bit as devastating to the integrity and legitimacy of the United States Government as would reneging on interest or on principal repayment of the national debt held by the public. Which raises an interesting question: The principal on Treasury-Inflation Protected Securities (TIPS) currently is adjusted for inflation using the CPI-U, not the CPI-W. Will the Chained-CPI also apply to TIPS, and if not, why not? If so, this switch would represent the first step in reneging on the full faith and credit of the United States Government. And if that is the case, which it indisputably would be, why isn't it also a crack in the full faith and credit of the United States Government to go back on the promise—the debt—to seniors who faithfully and diligently paid their payroll taxes every payday expecting the government to make good on its promise?

Prioritize Social Security and Cut Other Non-Essential Government Programs

Congress and the president have spent the United States to the brink of bankruptcy, and significant federal spending cuts must be made. However, there is more than adequate other extravagant and wasteful federal spending that can be cut to lower the deficit and reduce the national debt without touching Social Security benefits for current retirees.

To be blunt about it, proposals such as the Chained CPI are devious ways to take money out of seniors' pockets to pay for Congress's uncontrollable spending addiction. Proposals such as the Chained CPI hide behind technical jargon to renege on the promise Congress made three decades ago assuring workers that if they dutifully overpaid their Social Security taxes each and every payday of their working careers, their Social Security benefits would be secure.

Washington insiders become a sad parody of themselves when the co-chairs of the Bowles-Simpson Commission play Humpty Dumpty and make words mean whatever they want by putting out statements such as this one: "This change [Chained CPI] should not be regarded as a benefit cut or a tax increase. It should be regarded more as a technical change to achieve

Congress's stated goal of keeping pace with inflation in as accurate a way as possible."

So now "technical change" is right up there with "tax reform" and "entitlement reform" when it comes to Washington disinformation. No amount of hiding behind technical statistical jargon can hide the fact that the substitution of the Chained CPI for the CPI-W will cut Social Security benefits unjustifiably for current retirees, right now and for their rest of their lives.

Before Congress even thinks about cutting Social Security, it should lay off the hoards of meddling, counterproductive bureaucrats who have cushy government jobs at taxpayers' expense—jobs that pay twice what real workers earn in the private sector; bureaucrats who have Cadillac healthcare plans paid for by American taxpayers, many of whom can't even afford health insurance themselves; bureaucrats who have the best retirement system in the world, a retirement system Washington denies every other working American by keeping them chained inside the Social Security system which is a bad deal getting worse everyday that goes by.

Social Security is fundamentally different than any other government entitlement, both in what it promises and the inescapable dependency on government it creates. Social Security constitutes a form of serfdom that young workers are forced to enter under the penalty of unemployment or even imprisonment if they resist its shackles.

Once someone has toiled as a worker serf for a time, his servitude to the state becomes virtually inescapable, and emancipation for most people becomes impossible, even in theory. The point of no return occurs when the worker serf ceases being able to provide for his own retirement because so much of his earnings, which otherwise could have been used to invest in his own retirement, have been expropriated by the state to pay retirement benefits for existing retirees covered by the program. The worker serf is placated in his bondage with the promise that the government will force future worker serfs to do the same for him when he retires—a kind of reciprocal serfdom.

Social Security is unlike Medicare, where even after retirement a retiree theoretically could be cashed out of the program and set free to procure medical care on the open market through a private insurance arrangement—receiving better care at less cost than under Medicare and actually reducing government expenditures in the process. No such arrangement is feasible to replace a retiree's dependence on government retirement-income payments once the worker passes beyond the point of no return. Like the bite of a vampire, the government's sucking sustenance from the worker-host not only debilitates him; it also gradually transforms him from worker-host into retiree-parasite.

Yes, Social Security is broken for the long run but the problem cannot be fixed quickly or cheaply, and it certainly cannot be fixed by doubling down on the current model, namely forcing everyone to work longer, chiseling benefits, raising taxes or turning the program into a gigantic welfare program by means testing it.

There is, fortunately, a simple way out of this mess, a solution that allows Social Security to heal itself.

Free To Choose

The whole idea of a coercive, government-woven retirement safety net, for which all are forced to help pay, violates fundamental principles of liberty. But once the jaws of the snare have closed around so many people, as it has done since the inception of Social Security, it is difficult to extricate the victims without doing them considerable further harm.

That is why the only solution to reforming Social Security is to give everyone the choice between staying in the current system and receiving every penny they are currently promised or voluntarily opting out of the existing program into a new system that is both financially sound and more fully reflects the principles of liberty, namely allowing workers to invest the money they currently pay in Social Security taxes in the private market.

Many analysts have trapped themselves into believing this opt-out approach is fiscally undoable because of the so-called “transition” problem of paying the benefits of everyone who opts to remain in the old program while simultaneously allowing workers who opt out to direct a sufficient portion of their payroll taxes into a true retirement-saving plan. But, that is a false dilemma based on the false premise that it is impossible to cut other federal spending sufficiently to make up the revenues required to pay all benefits of those who remain in the old program.

The federal government has become so bloated that cutting and reallocating other federal spending could pay for the cost of paying all the benefits of everyone who wants to remain in the program. It is simply a matter of setting priorities and putting a practical and just solution to the Social Security problem near, if not at, the top of the list. As I demonstrate below, Social Security already has become such a bad deal for younger workers—and it is becoming a worse deal rapidly every year that goes by—that the system will naturally transition itself, in effect healing itself, as more and more younger workers opt out, thus rapidly reducing the out-year unfunded liability of the system.

Giving people the freedom to choose to leave Social Security voluntarily over time is the only practical and just solution to the Social Security dilemma. Trying to re-engineer the program in the committee rooms of Congress is doomed to make a bad deal even worse while it inevitably will shift costs in a counterproductive, anti-growth redistributive scheme. Turning Social Security into a gigantic welfare program that makes virtually everyone in the country dependent on government is the antithesis of a viable solution.

Policy makers who insist on cutting Social Security down to size and turning it into a welfare program are trapped in a time warp and don't seem to realize how dramatically the world of Social Security has changed. The original Social Security arrangement—where workers could indeed expect a considerably higher-than-market rate of return in Social Security benefits in exchange for the taxes they paid—has reversed itself. Many workers retiring today can expect to receive a negative return on the exchange, and that number will grow in the future.

Research conducted by C. Eugene Steuerle and Stephanie Rennane of the Urban Institute, makes it possible to quantify the magnitude of the problem. Steuerle and Rennane calculate the “lifetime value” of both Social Security taxes paid by and benefits promised to workers/retirees:

"The 'lifetime value of taxes' is based upon the value of accumulated taxes, as if

those taxes were put into an account that earned a 2 percent real rate of return (that is, 2 percent plus inflation). The 'lifetime value of benefits' represents the amount needed in an account (also earning a 2 percent real interest rate) to pay for those benefits."

A couple of examples illustrate the magnitudes involved. (All amounts are in expressed in constant 2011 dollars adjusted to present value at age 65 using a 2 percent real interest rate.)

A two-earner married couple both retiring in 2011, who both earned the average wage (\$43,500 in 2011) throughout their working careers would pay a lifetime-value of Social Security taxes equal to \$611,000 and expect to receive a lifetime-value of Social Security benefits equal to only \$560,000. Right out the gate, then, this typical couple pays nine percent more in Social Security taxes than they can hope to recover in Social Security benefits, hardly a good deal. And now the president wants to cut those benefits more?

But what if, for the sake of comparison, Social Security were repealed and compensation were paid, say, by grandfathering all current retirees so they received all their promised benefits (still a negative return)? And, what if compensation also were expanded to grandfather in benefits, to a lesser extent, of older workers—the extent of the grandfathering being dependent upon how far past the point of no return a worker had gone in being able to replace Social Security benefits by accumulating retirement savings through private investment of the freed-up Social Security taxes he no longer would have to pay? Wouldn't it be possible, theoretically speaking to repeal the program for all workers who have not passed the point of no return? In theory, yes but let's look at the data to see what it implies.

A couple of average earners age 47 will turn 65 in 2030. By then, they will have paid the government a lifetime-value of Social Security taxes amounting to \$826,000, and they will receive benefits having an expected lifetime value of only \$721,000, a 15 percent discrepancy, which measures the increasing magnitude of the net loss Social Security is imposing on workers. [Had they been permitted to invest that same sum during their working careers and earned the average, after-tax rate of return to capital during that period—approximately three percent real—the lifetime value of their funds would have equaled slightly more than a million dollars at age 65.] If Social Security were repealed next year—again for the sake of demonstrating how far under water workers are submerged in the program—the value of the Social Security taxes this couple already paid since they began work at age 18 in 1983 would amount to \$369,000, which would become, in effect, abandoned assets.

What would this couple's chance of recouping lost benefits be if they could invest the freed-up income they no longer would be forced to pay in Social Security taxes after repeal? Using Steuerle's and Rennane's same assumptions, the couple would be able to accumulate at age 65 only \$277,000 by investing their freed-up Social Security taxes. So, under uncompensated repeal, this couple not only would be forced to forfeit without recompense all the taxes they had paid prior to repeal (\$369,000), they also would fall short of replacing the repealed Social Security benefits (\$721,000) by some \$444,000. Without providing compensation well down the age ladder, it is clear the bad deal becomes worse after repeal for a significantly sized cohort of workers too old to dig themselves out of the hole Social Security dug them into and too young to benefit from the Social Security windfall that profited their elders.

This hypothetical repeal scenario is meant to illustrate the unavoidable problems Congress will encounter if it tries to re-engineer Social Security without providing people a guarantee and a choice. This circle cannot be squared from inside congressional committee rooms.

A few back-of-the-envelope calculations suggest that most workers currently over the age of 30 would be harmed to some extent by an hypothetical uncompensated repeal solution. For example, the 47 year-old couple of average earners passed the point of no return around 1995. In other words, had Social Security been repealed in 1995 when they were 30, the couple would have been able to accumulate a lifetime value of retirement benefits of approximately \$692,000 at age 65 by investing their freed-up Social Security taxes at an after-tax, three-percent real rate of return, which still would fall four percent short of replacing the pre-repeal value of their promised lifetime Social Security benefits of \$721,000.

The point of this exercise is to illustrate that any reform imposed on everyone, from outright repeal to a re-jiggered pay-as-you-go scheme, necessarily will create new winners and losers and thus end up breaking faith with the American people. The only way out of this dilemma is first to prioritize Social Security at the top of America's spending priorities. Second, make an iron-clad commitment to pay all promised Social Security benefits, in full and on time, to any worker who desires to remain in Social Security. Third allow any worker who wants to do so to opt out of Social Security and direct their FICA contributions into a real retirement-saving plan. Fourth, cut the rest of government to pay for it. Workers past the point of no return will remain in the program while the vast majority of workers not yet beyond the point of no return will opt out in large numbers to get a better deal.

Social Security has become such a bad deal, getting worse everyday, that an increasing share of workers will opt out as time goes by, and the program will naturally go the way of the horse and buggy without the need to actually repeal or re-engineer it or go broke trying to salvage it as currently configured. Guaranteeing workers who choose to stay in the program all the benefits they have been promised—unadulterated by benefit cuts, COLA chiseling, means testing, higher minimum retirement ages and other re-engineering devices—will avoid a war between winners and losers and will eliminate the need to concoct a compensation scheme for losers, which itself would likely to turn into a politically manipulated boondoggle.

Conclusion

The following two principles should guide Congress in deciding how to overhaul Social Security:

- **Freedom to Choose:** Allow workers who desire to do so to opt out of the program and direct their FICA contributions into a true retirement program with a range of options.
- **Promises made, promises kept:** Guarantee workers who are in too deep to opt out that they will receive everything Social Security promises if they elect to remain in the program.

There is plenty of money available to overhaul Social Security and remain faithful to both principles, if only Congress would prioritize Social Security at the top of the list and cut the rest of excessive, non-essential federal spending to pay for it.

Thank you.